Supreme Court of the United States

October Term, 1945.

No. 244

AGNES SCHONGALLA, as Executrix of the Last Will and Testament of WILLIAM SCHONGALLA, Deceased,

Petitioner and Appellant Below,

AGAINST

HARRY M. HICKEY, United States Collector of Internal Revenue, 14th District of New York,

Respondent and Appellee Below.

Petition and Brief for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

EDWARD A. ALEXANDER,
Attorney for Petitioner.

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MAY IT PLEASE THE COURT: The petition of Agnes Schongalla, as Executrix of the Last Will and Testament of William Schongalla, deceased, respectfully shows to this Honorable Court:

Summary Statement of the Matter Involved.

Suit was brought in the United States District Court, Northern District of New York, for the recovery, after payment under protest and rejection of claim for refund, of about $13,780.36 and interest of Federal Estate Taxes assessed by the Bureau of Internal Revenue upon the inclusion in decedent's gross estate of certain life insurance policies payable to beneficiaries other than the Estate, as

to which petitioner claimed that the decedent possessed no incidents of ownership.

The District Court dismissed petitioner's complaint and such dismissal was affirmed by the United States Circuit Court of Appeals for the Second Circuit on May 2, 1945. Three opinions were written; two by the District Court, which heard reargument. The Circuit Court's opinion has not as yet been published in bound-volume but appears on the first page of the New York Law Journal of June 2, 1945. Copy of the opinion is appended to the certified transcript of record submitted herewith. The District Court's opinions appear at pages 81 and 99 of the record.

The case would bring up for review and determination by this Honorable Court the question as to whether, in an ordinary annual-premium life insurance policy by which the insured is given upon issuance thereof, no right to change beneficiary or any other incident of ownership, the incorporation of a provision that if the beneficiary should predecease the insured the latter and his estate shall receive the benefits, renders the proceeds of such policy taxable upon the insured's death even if, as in this case, the beneficiary actually survived (cf. *Helvering* v. *Hallock*, 309 U. S. 106).

The public importance of a correct decision on this point, as well as on the other points in this case, is manifest; the decision of the Circuit Court of Appeals was considered by the New York Law Journal to be of such importance that it was published on the front page for the benefit of the legal profession in its issue of June 2, 1945.

Besides its public and general importance, arising out of the foregoing considerations, the case is of particular importance because the Circuit Court sustained taxation of the life insurance policies in question by recognizing an "inchoate reformation" thereof in order to fix the basis for a tax, and in so doing by-passed the rights of the

beneficiaries, who were infants when the policies were issued, remained infants upon maturing of the policies by the insured's death, and were not parties to the proceedings; nor was the issuer of the policies a party.

* * * * *

William Schongalla died on January 12, 1938 at age 64, leaving him surviving his widow (petitioner), his 85-year-old mother, and two sons, William and Edward, then aged respectively eighteen and nineteen. At his death he left, besides other insurance on his life exceeding the statutory exemption of $40,000 (Sec. 302[g] Revenue Act of 1926) two policies issued by Union Central Life Insurance Company, identical in terms, of which one or the other of his sons was, respectively, the beneficiary. Each policy provided on its face for an endowment of $30,000 payable to the named beneficiary, "his administrators, executors, or assigns", on July 12, 1959, if insured be then living or, on his death before that time, for the payment of $30,000 (in lump sum) to the named beneficiary "his administrators, executors or assigns." Each policy stated on its face: "This policy is without privilege of change of beneficiary", and the date of issuance thereof as May 20, 1924; but at the time of decedent's death had attached thereto a rider in the form of an "Agreement Respecting Payment of Policy", also dated May 20, 1924, to which was subjoined an "acceptance" by the insurance company dated September 8, 1942. Under the terms of the rider the proceeds of the policy involved were made payable, in accordance with a certain settlement, Option No. 3 in the policy, in equal one-third instalments on the beneficiary's attainment of the respective ages of 24 years, of 30 years and of 35 years. Each rider also provided:

> "In the event my said son survives me, but dies before attaining the age of thirty-five years, the

> amount due at his death shall be paid to his executors, administrators or assigns.
>
> In the event I survive my said son, said net sum shall be paid to my executors, administrators or assigns."

Each policy provided in the body thereof that the privileges of surrendering the same for cash, converting the same into extended or paid up insurance, and of borrowing thereon, were exercisable by "the owner of the policy". Copies of the policies appear opposite pages 56 and 58 of the record. It may be here stated that both the District Court and the Circuit Court of Appeals conceded that *sans* the riders above mentioned "the owner" of each policy as matter of law would be the beneficiary; the riders alone and the circumstances and validity of their attachment engender the problems involved (pp. 86-87; 152).

The decisions of both lower courts turned upon the issue as to how the riders came to be attached to the policies, *after issuance without right to change beneficiary,* and the legal effect thereof. In connection with that issue, it appears from the facts, which were all stipulated below, (pp. 48 to 79; 92 to 98) that in applying for this insurance and for other coincidental insurance, all of which was to form a "family income or trust plan" the decedent had specified that the policies applied for were to be written without privilege of change of beneficiary; that originally the policies were written and issued without such privilege; that subsequently to their issuance, after request had apparently been made in insured's behalf by the agent of the insurance company upon the company's home office in Cincinnati, Ohio, for incorporation of the above mentioned riders containing the "trust plan" for these policies, and such request had been refused on that ground that: "The desired changes cannot be made * * * for the reason that the beneficiaries under these policies are minor children and

no right is reserved to change the beneficiary", (fol. 281) the agent of the Insurance Company advised its home office, as follows:

> "I have gone over, with Mr. Mabie, the question of the Settlement Option form desired on the 2 above numbered policies. We have discovered that a mistake was made in the application. This insurance is part of the large case written recently and placed by Mr. Mabie and was all sold and accepted on the trust fund plan.
>
> Mr. Mabie worked out a schedule providing for the family of Mr. Schongalla and providing for the establishing of a trust fund and the distribution of the proceeds. He realized that the Company would not issue a policy giving all of the wording in the policy itself and as he had previously done expected to have Settlement Option papers prepared, after policies were issued and accepted. He did not for a moment realize that on the application for these two policies the right was not reserved to change the beneficiary. These policies can not be accepted on their present basis. It is entirely aside from the manner in which the insurance was sold. Mr. Mabie stands ready to make affidavit to that fact. It will knock out entirely the program accepted and furnished for the insured who is now one of the largest policy holders with the Company. These facts are positive and I know them to be the truth.
>
> We know that upon reviewing this situation you will be most happy to prepare papers which you may date the same date as the application for they were as much a part of the original application and desire of the insured as the application itself.
>
> This insurance was applied for by the Corporation of which Mr. Mabie is President and the pre-

miums to be paid by the Corporation" (Letter dated August 18, 1924; pp. 95-96).

In response, the home office referring to the riders, designated as "certificates", wrote to the agent as follows:

> "Enclosed are certificates for the above numbered policies which I trust will be found satisfactory. I understand they are to be completed as of May 20, 1924 and to be considered as part of the application. The original forms must be returned with the duplicates for acceptance by an officer of the Company" (Letter dated August 22, 1924; p. 97).

Thereafter, on or about September 12, 1924, the riders were sent from the company's home office to its agent for delivery to the insured "to be attached to the policies", after having been "accepted" by an officer of the Company (p. 98).

Questions Presented.

Under the above given state of facts two issues were presented to the courts below:

(1) Whether the riders had been properly, legally and effectively attached to the policies, becoming part thereof; if they had not, no tax could accrue.

(2) If they had become parts of the policies, whether by virtue thereof any "incidents of ownership" resided in the decedent at his death to render the policies taxable (pp. 99; 152-153).

On the first issue, the courts below, in substance took the position that an error had been made in the issuance of the policies and that error was attributed to Mr. Mabie, the insurance agent, on the ground that "he knew the

wishes of the insured and chose the procedure to be followed to give effect thereto; he intended to have the insurance contracts prepared and accepted and to then have the same amended by making substantial changes therein"; that the attachment of the riders constituted the "correction of a mistake"; and that the insured had the right, regardless of the original issuance of the policies in a form not according him any such right, to make the alterations in question by way of "correcting" such mistake. The lower court based such "right" on an estoppel raised against the petitioner, the insurance company, and the beneficiaries by reason of their having "accepted" the riders and the terms thereof by acting thereon (pp. 87; 101); the Circuit Court on the insured's unexercised "inchoate" right to reformation, conforming the policies to the "actual" contracts of insurance which the court conceived to have been made *in principio* (pp. 155-158).

While the District Court regarded the "engrafting" of the riders upon the policies as a *de facto* if not *de jure* exercise of dominion over the insurance by the insured and held him therefore to have been recognized by the insurance company and to be recognizable in law as the "owner" of the policies for purposes of surrendering for cash, loan and other privileges of ownership (p. 87, fol. 261; p. 132, fol. 396) and apparently regarded a "transfer" of such ownership to have taken place with a reservation by the insured of a "possibility of reverter" by virtue of the "survivorship clause" contained in the riders, the Circuit Court did not adopt that view in its decision but held squarely that the insurance policies were to be regarded in law was reformed, *to include* the terms contained in the riders and that the inclusion among such terms of the survivorship clause made the policies subject to a "possibility of reverter" and rendered their proceeds taxable within the scope of this Court's decision in *Helvering* v. *Hallock*, 309 U. S. 106 (p. 158). While that case was not

mentioned *eo nomine*, all of the cases cited by the Circuit Court (*Chase National Bank* v. *U. S.*, 116 Fed. [2d] 625; *Commissioner* v. *Washer*, 127 Fed. [2d] 446; *Bailey* v. *U. S.*, 31 Fed. Supp. 778; *Goldstone* v. *U. S.*, 144 Fed. [2d] 373; and *Liebmann* v. *Hassett*, ... Fed. [2d] ....) rest upon that decision.

Statement Disclosing the Basis Upon Which It Is Contended That This Court Has Jurisdiction to Review; and the Reasons Relied on for the Allowance of the Writ.

Petitioner's prayer that this Court's jurisdiction be exercised is based on the following matters mentioned in Rule 38 of this Court:

1. The Circuit Court of Appeals for the Second Circuit has rendered a decision in conflict with decisions of another Circuit Court of Apeals (Eighth Circuit) on the same subject matter (*Walker* v. *U. S.*, 83 Fed. [2nd] 103) (*Helvering* v. *Parker* 84 Fed. [2d] 838) and in conflict with decisions of the Supreme Court (*Bingham* v. *U. S.*, 296 U. S. 211; *Industrial Trust Co.* v. *U. S.*, 296 U. S. 220).

2. It has decided an important question of local law relating to the reformation of contracts and to the necessity of having the parties interested therein before the court, and relating to the alleged ratification by infant beneficiaries of the acts of an insured, in a way in which, petitioner believes, is in conflict with applicable local decisions. (*Steinbach* v. *Prudential*, 172 N. Y. 471.)

3. It has decided an important question of general law, to wit, that in a tax case a contract may be reformed without the parties thereto being represented in the matter in which their rights were involved, in a way in which, we believe, is untenable and in conflict with the weight of authority. (53 C. J. 1003; 1006.)

4. The said Circuit Court of Appeals has decided an important question of federal law which, we believe, has not been but should be settled by this Court as to the taxation of life insurance, involving the interpretation of the statutes relating to Federal Estate Taxes, in a way which, petitioner believes, is in conflict with applicable decisions of this Court; and has so far departed from the usual and accepted course of judicial proceedings, as in sound public policy and justice to call for the exercise by this court of its power of supervision (see pp. 14, 23 post).

* * * * *

At the time of their issuance, on May 20, 1924, the aforementioned insurance policies provided for the payment on the endowment date or on death of the insured as the case might be, of the lump sum of $30,000 to the beneficiary. The insured was given no right to change beneficiary nor any other incidents of ownership. The beneficiaries were, as matter of law, the owners of the policies.

> *Pennsylvania Company* v. *Commissioner of Internal Revenue,* 79 Fed. (2d) 295; certificate denied 296 U. S. 261;
> *Ruckenstein* v. *Metropolitan Life Insurance Co.,* 263 N. Y. 204;
> *Ryan* v. *Rothweiler,* 50 Ohio State, 595;
> *Morgan* v. *Penn Mutual Life Ins. Co.,* 94 Fed. (2d) 129.

The District Court found as fact:

> "The policies were issued in this manner, at the instance of the writing agent of the company, because he realized that the insurance company would not issue a policy containing the language necessary to cover the decedent's 'trust fund plan,' which was known to and well understood by the agent, and it

was purposed and intended to have settlement option papers covering such plan after the policy was issued and accepted, which, in order to express the full intention of the insured, the company's agent knew would require additional agreements relating to the settlement option to be prepared, signed by the insured and accepted by the company, which could only be accomplished legally if the right to change the beneficiary had been reserved. The writing agent of the company knew the wishes of the insured and he chose the procedure to be followed to give effect thereto; he intended to have insurance contracts prepared and delivered, and further intended to amend them by making substantial changes therein. The insured had knowledge of the procedure used, for he was a party to it. *When the policies were issued and delivered, the insured had the option of accepting or rejecting them in their entirety he accepted them.* Each of the policies contained the following provisions:

'33. *Authority.* None of the terms of this policy shall be modified, nor any forfeiture under it waived, save by an agreement in writing, signed by the President, a Vice-President, the Secretary or an Assistant Secretary, whose authority for this shall not be delegated.

34. *Settlement Options.* The owner of this policy, by written notice to the Company at its home office, for which a form will be furnished on request, may elect to have the net sum payable under this policy paid in either of the following ways in lieu of in a single sum:' (pp. 131-2, fols. 392 to 395).

* * * * *

> "After issuance of the policies, and in order to conform them to his wishes and insurance plan, *the decedent, insured, as owner (under paragraph 34)* exercised *his right* to elect a 'Settlement Option' by executing, upon forms furnished by the company for that purpose, an agreement with respect to each policy, * * " (Italics ours.) (p. 132, fol. 396.)

These findings were approved and paraphrased by the Circuit Court; but that Court added thereto the following:

> "Although the Trial Court's findings of fact do not expressly state that the reservation of the privilege to change the beneficiary *was omitted by mistake from the policies as originally issued*, his opinion on reargument shows that 'the erroneous form of the application *may* have been the fault of the writing agent' * * *. Such mistake gave an insured the right to obtain reformation of the policy to conform to the actual contract of insurance." (Italics ours.) (p. 155.)

In making this assumption, and basing thereon its conclusion that the policies ought to be regarded as reformed by reason of mistake, the Circuit Court made no warrantable inference of fact from the trial Court's findings but, on the contrary, disregarded the finding that the insured *had accepted the policies as written.* In the face of that finding, reformation could not possibly have been decreed in a direct suit; much less collaterally.

> *Avery* v. *Equitable,* 117 N. Y. 451.

However, there is nothing in the record to warrant the conclusion that a mutual *mistake of fact* was made in having the policies issued without right to change beneficiary; on the contrary, the insured did on four occasions

evidence his wish to have the policies issued without that right. Thus, in the application for this insurance the following separate statements appear:

> 5. a beneficiary (~~with privilege to change on written request)~~.
>
> 6. Have you any present intention of changing the beneficiary or assigning the policy? No.
>
> (See application attached to policy, p. 56.)

Again, and as found by the District Court, the policies were actually issued without right to change beneficiary, were accepted by the insured in that form, and were retained by him for over two months (p. 101, fols. 303-4; p. 131, fols. 393-4). Finally, on executing the riders, the insured did so only after elision of a clause therein reserving the right to change beneficiary, etc., as follows:

> ~~The insured reserves the right, at any time during the continuance of the policy, without the consent of any beneficiary, to revoke this agreement, or to change the beneficiary, or to revoke this election of settlement option, or to exercise every right and receive every benefit reserved by the said policy to the insured or to the owner of the policy during his lifetime, or to agree with the Company to any change in or amendment of the said policy~~. (See riders attached to policies at pp. 56 and 58.)

It is possible, if not even of more compelling cogency under the evidence, that error *of law* was made on the part of the agent in supposing that the policies could be amended despite the failure to reserve the privilege of changing beneficiary. His error may very well have arisen out of misconception of the term "owner" to whom the right to select settlement option was given. The Dis-

trict Court's findings would support such a conclusion; they do not support a conclusion that the policies ought to stand reformed because an error was made in not originally writing them with right to change beneficiary. If the error was of the character suggested, it is clear that no reformation or other relief would have been legally possible.

> *Dampskibs Aktieselskabet Thor* v. *Tropical Fruit Co.*, 281 Fed. 740;
> *In Re Gordon*, 313 Pa. 118, 169 A. 85;
> *Baird* v. *Publishers', etc.*, 199 N. W. 757.

Furthermore, referring to the riders, the District Court said (p. 87, fols. 259-260):

> "Grave doubt may be entertained as to the validity of the agreement."

Error need not, however, rest exclusively upon the illegality of the riders; even if they were effective, taxation was erroneous and unlawful, and insofar as the Revenue Act of 1926 was construed as covering this insurance, the same must be regarded as unconstitutional and violative of Article I, Section 9 of the Constitution of the United States, since it purports on its face (Sec. 302[g]) to levy a direct tax not proportioned, and such levy has in fact been sustained.

> *Chase National Bank* v. *U. S.*, 278 U. S. 237;
> *Llewelyn* v. *Frick*, 268 U. S. 238;
> *Wyeth* v. *Crooks*, 33 Fed. (2d) 1018.

Under the riders all privileges of ownership under the policies during the lifetime of insured and beneficiary were possessed by the beneficiary (*Pennsylvania Co., etc.* v. *Commissioner, supra*) and it was stipulated that only if

the beneficiary should die before the insured the latter and his estate should receive the "net sum" under the policies. The contingency did not occur, and in point of fact the beneficiary did at all times and in completeness own the policies; the insured had nothing at any time but a prospect of becoming the owner. While the Courts below regarded this prospect as a "possibility of reverter" comparison of the facts in this case and in the cases, including *Helvering* v. *Hallock,* 309 U. S. 106, cited by the lower Courts, compels the conclusion that the principle of *Helvering* v. *Hallock* is not applicable and has been unwarrantably extended.

On the question as to whether the mere reservation of a possibility or prospect of ownership on the part of the insured is an "incident of ownership" sufficient to give rise to the tax, the decisions cited by the Circuit Court below in support of its position affirming the proposition have held *Bingham* v. *U. S.,* 296 U. S. 211 and *Industrial Trust Co.* v. *U. S.,* 296 U. S. 220, to have been overruled by *Helvering* v. *Hallock, supra.* This question has not apparently been determined by this Honorable Court. Furthermore, there is conflict among the Circuit Courts in several circuits on this question,

> Cf. *Walker* v. *U. S.,* 83 Fed. (2nd) 103;
> *Helvering* v. *Parker,* 84 Fed. (2nd) 838;
> *Washer* v. *U. S.,* 127 Fed. (2d) 446,

and a lack of unity of understanding as to the bounds of *Helvering* v. *Hallock, supra,* appears to exist among the lower courts for which clarification ought to be had before decisions multiply upon misinterpretation.

* * * * *

Two other policies both issued by Metropolitan Life Insurance Company of relatively less importance were involved in the litigation: The one, a $3,000 policy issued

on October 20, 1903, designating as beneficiary Minna Schongalla, mother of the insured "if living otherwise to the legal representatives of the insured", contained no reservation of right to change beneficiary and specified that the loan and cash surrender value and all other rights under the policy were to be exercised "as the insured *and* assured may elect"; the other, a $112.19 industrial policy issued on April 10, 1892, contained a Facility of Payment clause, but Minna Schongalla, mother of the insured had been designated as beneficiary (pp. 60, 62).

The lower courts sustained the tax with respect to both of these policies, but petitioner claims such taxation to be erroneous on the grounds that both policies had been issued prior to the effective date of the Revenue Act of 1918 first extending the Estate Tax to Life Insurance; that no right to change beneficiary or any right to enjoy benefits under either policy ever resided in the insured; that with respect to the $3,000 policy the privileges of ownership, to be exercised "as the insured *and* assured may elect", were not possessed by the decedent since the consent of the beneficiary was indispensable (*Reinecke* v. *Northern Trust Co.*, 278 U. S. 339; and that by the specification of a named beneficiary the Facility of Payment clause in the $112.19 policy was inoperative, since the beneficiary survived.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket as No. 19624, Agnes Schongalla, as Executrix of the Last Will and Testament of William Schongalla,

deceased, plaintiff-appellant, against Harry M. Hickey, United States Collector of Internal Revenue, Fourteenth District of New York, defendant-appellee; that the judgment of said Circuit Court in said case be reversed by this Honorable Court, and that your petitioner may have such other and further relief as may be just and proper; and your petitioner will ever pray.

AGNES SCHONGALLA,
Petitioner.

EDWARD A. ALEXANDER,
Counsel for Petitioner.

BRIEF SUPPORTING THE FOREGOING PETITION.

POINT I.

It was error to hold the riders and their attachment valid; and if such riders were not validly attached, the policies were not taxable.

Both of the lower courts found as fact that the writing agent, Mr. Mabie, intended to have the policies issued and become effective and to thereafter amend them by means of the riders. The District Court found in particular that the insured having received the policies in their original form had "the option of accepting or rejecting them in their entirety, he accepted them" (fols. 393-4). That the Court regarded the policies as having become legally operative and binding upon such "acceptance" by the insured cannot admit of doubt, for the Court found further, as fact, that "the decedent-insured *as owner* (*under paragraph 34*) exercised his right to elect a 'Settlement Option'" (fol. 396). In its decision underlying these findings of fact, the Court had said:

> "When the policies were issued and delivered, the insured had the option of accepting or rejecting same in their entirety. He apparently accepted them retaining them *in their original form* for over two months and then succeeded in engrafting upon them the agreements accepted by the insurance company on September 8, 1924" (fols. 303-4).

These findings were in no way disturbed by the Circuit Court and they are in no way inconsistent with the view that if an error was made by the insurance agent it

was an error of law in supposing that the policies could be amended by the insured "as owner" despite the failure to reserve his right to change the beneficiary. The right to select a settlement option was given to "the owner", without definition of that term.

Not only did the District Court recognize the effectiveness of the policies as originally issued, but it also recognized the impropriety of any attempt on the part of the court to reform the policies in this litigation, for in one part of its opinion it said:

> "The recognition of plaintiff's claim would amount to a reformation of the insurance contracts *without the necessary parties being before the court or the revision of the contracts by judicial construction.*" (Italics ours.) (fol. 302.)

That Court found its way out of the dilemma by holding that the insurance company had recognized the insured as "owner"; that he had acquiesced in such recognition, estopping his estate from negating it, and that the beneficiaries were also estopped because they had accepted the benefits under the policies and riders (fols. 260; 303). The beneficiaries were infants when the insured died, and had no knowledge of the facts relating to the riders (fol. 260; p. 151). How could they ratify or be estopped by taking money without knowledge of the facts?

The District Court's finding that the policies became effective, as originally written, is supportable.

> *Interstate Chemical Corporation* v. *Duke,* 176 App. Div. (N. Y.) 684 at 693, 4 and cases cited.

Any conclusion therefrom that they could thereafter be amended was clearly erroneous.

> *Avery* v. *Equitable,* 117 N. Y. 451.

Dampskibs Aktieselskabet Thor v. *Tropical Fruit Co.*, 281 Fed. 740 at 743;
In re: *Gordon*, 313 Pa. 118, 169 A. 85;
Baird v. *Publishers', etc.*, 199 N. W. 757;
Pennsylvania Co. etc. v. *Commissioner of Internal Revenue*, 79 Fed. 2nd 295;
Ruckenstein v. *Metropolitan Life Ins. Company*, 263 N. Y. 204;
Ryan v. *Rothweiler*, 50 Ohio St. 595;
Manhattan Life Ins. Co. v. *Smith*, 44 Ohio St. 156;
Caplin v. *Penn Mutual Life Ins. Co.*, 100 Misc. 374;
Davis v. *Modern Industrial Bank*, 279 N. Y. 405;
Morgan v. *Penn Mutual Life Ins. Company*, 94 Fed. 2nd 129.

Estoppel against the infant beneficiaries, or implying their consent to the affixation and the terms of the riders, could not properly be invoked to toll the law.

15 C. J. S. 980;
Matter of McNeil, 165 App. Div. (N. Y.) 842;
31 C. J. 1004-1009.

In view of the District Court's findings of fact and the conclusions of law properly and necessarily to be drawn therefrom, the Circuit Court should have reversed the judgment of the District Court, for the acceptance of the policies and retention of them either foreclosed the insured if an error of fact was involved in writing the policies without right to change beneficiary and no reformation could have been obtained.

Interstate Chemical Corp. v. *Duke* (*supra*),
Avery v. *Equitable* (*supra*),

or, if an error of law were involved in supposing that the policies could be amended, no relief therefrom could have been had by the insured.

> *In re Gordon* (*supra*);
> *Baird* v. *Publishers', etc.* (*supra*);
> *Dampskibs Aktielskabet Thor* v. *Tropical Fruit Co.* (*supra*).

The Circuit Court, however, while ostensibly accepting the district Court's findings, added:

> "Although the Trial Court's findings of fact do not expressly state *that the reservation of the privilege to change beneficiary was omitted by mistake from the policies as originally issued,* his opinion on reargument shows that 'the erroneous form of the application *may* have been the fault of the writing agent'." (Italics ours.) (p. 155.)

This "finding" by the Circuit Court was most material to its decision, for the gist of its opinion was that the parties had intended to obtain policies reserving the right to change beneficiary. *There is neither evidence nor finding of fact by the Trial Court to support any such view.* As a matter of fact, although each policy provided (Paragraph 28):

> "Unless it is stated on the first page hereof that the policy is *without* privilege of change of beneficiary, the insured, without the consent of any beneficiary, may exercise every right and receive every benefit reserved to the insured or the owner of the policy * * *."

there was *typed in* on its face:

> "THIS POLICY IS WITHOUT PRIVILEGE OF CHANGE OF BENEFICIARY."

There was, therefore, no error of omission; the policies were written, in this respect, precisely as ordered—and what the Circuit Court's "finding" amounts to is that the insured's application for the policies ought to be reformed because, in order to make the riders effective under a plan of attaching them *after* issuance of the policies, the right to change beneficiary *ought* to have been reserved, and that the "failure" to reserve it, *may* have been the fault of the writing agent. Since the evidence discloses only that it was the insured's intent *not* to have the right to change beneficiary, it is obvious that this "finding" is pure conjecture, and a rationalization of the conclusion that the riders *are* to be recognized.

The cases cited by the Circuit Court in support of its decision (*Williams* v. *North German Ins. Co.*, 24 Fed. 624; *Ulman* v. *Equitable Life Insurance Soc.*, 161 App. Div. 708; *Goldsmith* v. *Union Mutual Life Insurance Co.*, 18 Abb. N. C. 325 (N. Y.); *Snell* v. *Insurance*, 98 U. S. 85; *National Reserve Ins. Co.* v. *Scudder*, 71 Fed. (2nd) 884; *German Life Ins. Co.* v. *Gueck*, 130 Ill. 345; *Bosse* v. *Bosse*, 248 Ky. 11, *Woodfin* v. *Neal*, 16 Tenn. Appeals 481; *Globe Insurance Co.* v. *Boyle*, 21 Ohio State 119, etc.) are altogether inapplicable. They were actions for reformation of contract brought by the insured, to which those interested were parties. Reformation of the policies involved in this litigation is not and cannot be at issue since the parties are not before the court; and the Circuit Court recognized the weakness of its position in this respect by stating:

> "But if we are wrong as to this and effective reformation could only be had by a court proceeding, the appellant's position would not be bet-

ter, for at any time before his death the insured by bringing such a suit *could have obtained a decree that the actual contract of insurance made by the parties required the proceeds to be paid in accordance with the terms set forth in the rider.* In a suit upon the contract of insurance, where such procedural right to reform the policy exists, the courts often give the same relief as though a decree of reformation had actually been obtained. *Aetna Insurance Co.* v. *Brannon,* 99 Tex. 391, 89 S. W. 1057. See also *Stevens Institute of Technology* v. *Sheridan,* 30 N. J. Eq. 23. We see no reason why this principle should not be applied in litigation involving the taxability of the insurance." (Italics ours.) (pp. 157-158.)

How can it be decided in this case that the insured could have obtained a decree in reformation? Had the infants been made parties to any suit for reformation, guardians in their behalf might have produced evidence, not in this record, which would have entirely destroyed or defeated the contention that the insured had the right to reformation. Furthermore, on the evidence and findings of fact in this record it is *prima facie* clear that the insured was *not* entitled to reformation.

To say that the insured "*could have obtained a decree that the actual contract of insurance made by the parties required the proceeds to be paid in accordance with the terms set forth in the rider*" is to beg the question. Certainly if the findings of a court trying that issue were "that the insured had accepted the policies as originally written," under a misapprehension shared by him and the writing agent that he was "the owner" of the policies and could amend them, the insured would not be entitled to any such decree.

In the first paragraph of Point II, *infra*, further reason is given why the Circuit Court's recognition of a pseudo-reformation of these policies was erroneous.

POINT II.

Even if the riders are to be regarded as parts of the policies, the proceeds are not taxable because the deceased had no incidents of ownership therein.

In view of the absence of a full presentation of an issue as to alleged "mistake" in the policies, and, for that matter, the lack of jurisdiction, by reason of the absence of necessary and proper parties and pleadings as to that issue, the Circuit Court's upholding of the validity of the riders cannot be regarded as encompassing the idea that the policies stand reformed to the extent that they *were* (as reformed) originally issued with reservation of the right to change beneficiary. All that can be said with even a semblance of judicial propriety is that attachment of the riders stands ratified; *i. e.*, that there are before the Court policies (giving no right to change beneficiary) of which the riders in question *are* parts. To hold otherwise is not only outside of the issues presented, but would do violence to the evidence, for the insured's four-time expression of intent to have the policies issued without benefit of reservation to him (see p. 11, *ante*) stands uncontested, and, since it is apparent that the policies *could* have been issued originally with the riders, or at least the substance thereof attached or incorporated, thereby fully carrying out the insured's expressed purposes, it will not do to say, upon the evidence, that the insured did at any time have the right to change beneficiary. Semble, a special guardian for the infant beneficiaries might very well, on the issue of "mistake" have been able to prove that the "mistake", if any, lay in

misinterpretation of the legal meaning and effect of "owner" of the policies as therein used; in which event, the right to reformation envisaged by the Circuit Court could not have existed.

In fine, and in substance, there is presented, in this case, if the riders are to be regarded as parts of the policies, the question as to whether policies giving no rights or incidents of ownership to the insured, save only the right of *becoming* owner upon the beneficiaries' prior death, are directly or by analogy within the purview of this Court's decision in *Helvering* v. *Hallock,* 309 U. S. 106. While the Circuit Court did not cite that case, it did rely on its own decisions in *Chase National Bank* v. *U. S.,* 116 Fed. (2nd) 625 and *Goldstone* v. *U. S.,* 144 Fed. (2) 373, and upon *Commissioner* v. *Washer,* 127 Fed. (2d) 446, *Bailey* v. *U. S.,* 31 Fed. Supp. 778 and *Liebman* v. *Hassett,* .... Fed. (2d) ...., all citing and relying on *Helvering* v. *Hallock.*

* * * * *

Bingham v. *U. S.,* 296 U. S. 211 and *Industrial Trust Co.* v. *U. S.,* 296 U. S. 220 have heretofore been the settled law, upon the strength of which, undoubtedly, much insurance has been written in the belief that the mere taking of a precautionary measure by the insured against the contingency of the prior death of his beneficiary, to enable him to *then, and only then* make a redesignation, would not subject to tax and depletion of the benefits intended for his beneficiary, insurance not otherwise taxable. In view of lower court rulings, hereinafter referred to, there is need, it is submitted, to reaffirm the decisions above cited, by reversing the judgment in this case—if this Court, too, should hold the riders effective.

* * * * *

The idea that this case may be *directly* controlled by the principle of *Helvering* v. *Hallock* may be immediately dismissed. A parallel to *Helvering* v. *Hallock* might have

existed if the insured, having control over the policies in his lifetime, had transferred that control contingently upon his death. As a matter of fact such was the situation presented to the court in the *Bailey* case where the insured had the right to change beneficiary, was "life owner" of the policies, and subsequently assigned the policies reserving unto himself, however, a right of reverter upon the beneficiary's prior death. By analogy, in *Chase National Bank* v. *U. S.* (116 Fed. [2d] 625) where the insured became entitled to payment of the endowment under his policy, but instead of accepting it, converted the policy into a paid up policy, and in doing so transferred the funds payable and relinquished his control, contingently however upon his death, a situation was presented which might very well have been governed in principle by *Helvering* v. *Hallock*. These cases are properly governed by Section 302(c) of the Revenue Act, and the fact-situations in them are obviously proper subjects for the application of an estate tax since in all of them the privilege of transferring his property has been exercised by the deceased with completion of such transfer abiding his death. If, however, the nature of the tax be borne in mind, namely, that an excise is levied upon the privilege of passing-on one's estate, it is difficult, if not impossible to conceive how the tax could properly apply to property in which the decedent never had any interest, and which accordingly he could not pass on; property which was never a part of his estate and could therefore never be transferred from his estate, either in whole or as to any element of title.

That the decedent must at some time have had a property right in insurance is not only instinct in the nature of the tax, but has been judicially affirmed by this Court and other courts many times.

> *Chase National Bank* v. *U. S.*, 278 U. S. 237;
> *Llewelyn* v. *Frick*, (*supra*);

Wyeth v. *Crooks*, 33 Fed. (2) 1018;
Helvering v. *Tetzlaff*, 141 F. (2) 8.

If it be conceded that "property" in an insurance policy consists of the ability to control, in whole or in part the proceeds thereof, then the absence of such control would demonstrate the lack of "property" in the ordinary sense; and unless the taking out of the policy by the insured or his payment of, or agreement to pay premiums, or the provision that if he should outlive his beneficiary he would obtain control of the policy, constituted a special "property" in a sense peculiar to the Estate Tax the tax would not apply. The mere taking out of the policy and the payment of premiums thereon cannot be considered as themselves giving rise to taxation because they do not in their nature represent the exercise of any privilege of passing "property" on, and the question is begged if the "property" is the policy or its proceeds. Furthermore, the taking out of a policy and payment of premiums thereon by deceased is presupposed in the vast majority of cases under the statute, which involves insurance "taken out by the decedent upon his own life, payable to beneficiaries other than his estate", and yet the mere taking out of such insurance, payment of premiums thereon, and the accrual of the death benefit thereunder has not been regarded as self-sufficient to give rise to the tax. *Chase National Bank* v. *U. S.*, 278 U. S. 237.

As to the reservation that upon prior death of the beneficiaries the insured or his estate shall become entitled to the proceeds, a realistic understanding and application of the tax must lead to the conclusion that no taxable incident is presented unless such reservation represents the consummation of a transfer of ownership or control previously vested in the insured; for if, as in this case, by failure of the condition of "reverter" no under-

lying transfer of property has been completed, the insured's death does not terminate any property interest on his part which could reasonably be regarded as part of his "net estate", but demonstrates that he and his estate, never having had such property interest, can never acquire one.

> *Lloyd's Estate* v. *Commissioner,* 141 Fed. (2d) 758.

In *Helvering* v. *Hallock, Chase National Bank* v. *U. S.* and *Bailey* v. *U. S.,* the death of the settlor, grantor or insured, as the case may be, did conclude dispositions of his property by transfer previously made, and vested in beneficiaries interests not theretofore possessed in their entirety; whereas in this case, the insured's death added nothing, by way of title, which did not already exist, *ab initio,* in the beneficiaries.

It might be observed also that a life insurance policy payable to beneficiaries other than the insured's estate does not on maturity form any part of the decedent's estate, but represents a third-party-contractual payment by a stranger to the estate, outside of and without regard to the administration thereof. If it is to be taxable as part of the "net estate" of the decedent upon the transfer of which the tax is laid, it must obviously be brought into his estate by some connecting act or interest on his part, and the only relevant provision made by the Revenue Act for bringing into an estate property not ordinarily a part of it, is that contained in Section 302(c) dealing with transfers made in contemplation of death or intended to take effect in possession or enjoyment at or after death, and which by particularly specifying an "interest" in property (Section 302, 1st paragraph) of which the decedent has made a transfer precludes anything but a *transfer,* regardless of what may have been said in other cases and in other situations, where the court has

held that a "transfer" is not necessarily an element of the tax.

In this connection, it should be remarked that in *Helvering* v. *Hallock* a *reversion* resided in the decedent for practical and real purposes, although the intervention of a trustee might technically have made such reversion a "possibility of reverter" in law, and the decedent's death actually vested in the beneficiaries larger estates than the previously given life estates, *i. e.*, transmuted this reversion. There is no propriety, however, in identifying the "reversion" in *Helvering* v. *Hallock*, and the so-called "possibility of reverter" in this case, for while such language as "the beneficiary's title was ripened by the death", or "until the insured's death, the beneficiary was never certain of his title" might at first blush appear to be applicable, its irrelevancy is perceptible if it be considered that the tax is laid upon the privilege of *decedent's* transferring his net estate, and that unless an interest on his part, in life or at death, in the property sought to be taxed is discernible, no tax may constitutionally be levied, regardless of what effect his death may have had on the property of another.

It is submitted that the following statement of the law by the Circuit Court, Eighth Circuit, in *Walker* v. *United States*, 83 Fed. (2nd) 103 is correct and applicable to this case. The Court said (at p. 107):

> "(5) Obviously, the provision here involved of this act is ambiguous. When the words 'taken out by the decedent upon his own life' are attempted to be applied in practical administration to the subject-matter of life insurance, varying situations are found which at once present difficulties as to what the congressional intention was. It must be kept in mind that this is an *estate tax* upon the proceeds of life insurance. *An estate tax is an excise tax upon the privilege of transferring or*

transmitting property by reason of death and is not a tax on the property itself. It follows that unless there is such a transfer FROM THE DECEDENT—UNLESS THERE WAS SOMETHING WHICH PASSED FROM THE DECEDENT UPON DEATH—*there has been no transfer; no privilege of transfer has been exercised; and there is nothing which can be subjected to an excise tax on such privilege. Therefore, where life insurance* proceeds are involved, the initial inquiry is as to what, if anything, has passed *from the decedent* because of his death." (Italics in part ours; in part by the Court).

* * * * *

and at p. 110:

"These policies were issued some years before the Revenue Act of 1926. They were applied for and the entire premiums paid by the decedent. In each of the policies appellant was the sole beneficiary with a provision that, should she not survive insured, the proceeds were payable to his estate. There was no reserved right in the insured to change the beneficiary."

* * * * *

also at p. 110, referring to "possibility of reverter" provisions:

"For several reasons, appellee contends the above provisions of these policies left incidents of ownership in decedent which prevented them fully vesting in appellant, and that, because thereof, the proceeds formed part of the taxable gross estate. The first of these reasons is that the beneficial interest in the policies passed to appellant only if she survived decedent—otherwise passing to the estate. The argument is that 'the death of the decedent * * * was the indispensable event giving rise to, or at least enlarging, valuable property

rights in the appellant not theretofore possessed or enjoyed.' In support, appellee cites cases dealing with property transfers *inter vivos* dependent upon and vesting only at death of the transferer. *Bingham* v. *United States*, 296 U. S. 211, 56 S. Ct. 180, 80 L. Ed.—, definitely determines this argument against appellee—see *Industrial Trust Co., et al.* v. *United States*, 296 U. S. 220, 56 S. Ct. 182, 80 L. Ed.—, and also see *Becker* v. *St. Louis Union Trust Co.*, 296 U. S. 48, 56 S. Ct. 78, 80 L. Ed.—(a trust transfer *inter vivos*)."

* * * * *

and at p. 111:

"Congress expressly recognized and treated proceeds from insurance on the life of a decedent as a separate matter from the situation dealt with in section 302(d). Therefore, section 302(g) is not controlled or affected by section 302(d), and a construction of the latter is not controlling in determining the meaning and application of the former Section 302(g). Second, section 302(d) deals only with 'transfers' of property *from the decedent. Here there was no transfer from decedent within the meaning of that section or at all. The property rights here find birth in the policy; are as between the beneficiary and the insurer; and the rights of the beneficiary came into being with the life of the policy.* The result is that the proceeds of these two policies are not taxable under the Revenue Act of 1926 as part of the gross estate of this decedent." (Italics ours.)

Respectfully submitted,

EDWARD A. ALEXANDER,
Attorney for Petitioner.

APPENDIX.

Statutes Referred To.

Revenue Act of 1926, As Amended:

Sec. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated——

* * * * *

(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, except in case of a *bona fide* sale for an adequate and full consideration in money or money's worth. * * *

* * * * *

(g) To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life.

INDEX

CITATIONS

663297—45

In the Supreme Court of the United States

October Term, 1945

No. 244

Agnes Schongalla, as Executrix of the Last Will and Testament of William Schongalla, Deceased, petitioner

v.

Harry M. Hickey, United States Collector of Internal Revenue, Fourteenth District of New York

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinions of the District Court (R. 81, 99), one after reargument, are not officially reported. The opinion of the Circuit Court of Appeals (R. 150) has not yet been officially reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 18, 1945. (R. 158.) The petition

for a writ of certiorari was filed on July 19, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended, by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the proceeds of certain life insurance policies taken out by the decedent upon his own life were properly included in the value of his gross estate for estate tax purposes, under Section 302 (g) of the Revenue Act of 1926, as amended.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations are printed in the Appendix, *infra*, pp. 10–11.

STATEMENT

The facts found by the District Court (R. 130–136), in substance, are as follows:

The taxpayer, as executrix, sues to recover estate taxes and interest, allegedly overpaid on the estate of William Schongalla, a resident of New York, who died January 12, 1938, and was survived by his wife, two sons and his mother (R. 130).

In addition to other life insurance, aggregating more than $40,000, payable to beneficiaries other than his estate, there were in force upon the decedent's life at the time of his death two policies issued by Union Central Life Insurance Company, dated May 20, 1924, the proceeds of each

of which were $30,100.05, a policy issued by Metropolitan Life Insurance Company, dated October 20, 1903, the proceeds of which were $3,-228.89, and an industrial policy issued by Metropolitan Life Insurance Company, dated October 10, 1892, the proceeds of which were $112.19. All premiums on all of the policies were paid by the decedent or by a corporation of which he was the sole stockholder. (R. 130.)

The decedent had purchased the two Union Central Life Insurance Company policies in furtherance of a comprehensive general insurance "trust fund" plan then being arranged to meet his requirements. They were of the endowment type and identical in terms, except that one of the sons was named as beneficiary in one policy and the other son as the beneficiary in the other. Each policy, as written, provided that upon the maturity date, July 12, 1959, or if the insured should die prior thereto, the proceeds should be paid to the beneficiary, or to the beneficiary's executors, administrators or assigns. (R. 131.) These policies, as originally written, did not reserve the right to change the beneficiaries. The policies were issued in this manner, at the instance of the writing agent of the company, because he realized that the company would not issue a policy containing the language covering the decedent's "trust fund plan", and it was intended to incorporate the necessary provisions subsequently through the medium of a

supplementary agreement relating to the settlement option; and such agreement was possible only if the right to change the beneficiary had been reserved. The agent knew the wishes of the insured and he chose the procedure to be followed to give effect thereto; he intended to have insurance contracts prepared and delivered, and further intended to amend them by making substantial changes therein. The insured knew the procedure used, and accepted the policies, although he had the option of accepting or rejecting them in their entirety. (R. 131–132.)

Each of the Union Central Life Insurance Company's policies provided, in paragraph 33, that none of the terms of the policy could be modified except by an agreement in writing signed by a specified officer of the company; in paragraph 34, that the owner of the policy, by written notice to the company, for which a form would be furnished on request, could elect to have the proceeds of the policy payable, in lieu of a single sum, in either of several ways known as "Settlement Options". Paragraph 37 contained "Option 3. Retained at interest". (R. 132.)

After issuance of the Union Central Life Insurance Company's policies, and in order to conform them to his wishes and insurance plan, the insured, as owner (under paragraph 34) exercised his right to elect a "Settlement Option" by executing, upon forms furnished by the company for that purpose, an agreement with respect to each

policy (R. 132–133), which agreement provides (R. 133):

> I hereby give notice of change of beneficiary and election of settlement option under the above described policy and request payment of the net sum payable under the said policy in the event of the death of the insured as follows:
>
> The net sum payable under the above numbered policy, in the event of my death before it matures as an endowment, shall be retained by the Company in accordance with the provisions of Settlement Option #3 in said policy, * * *
>
> * * * * *
>
> In the event I survive my said son, said net sum shall be paid to my executors, administrators or assigns.
>
> Except as hereinbefore provided, no benefit accruing to any beneficiary under this agreement shall be transferable, or subject to commutation or encumbrance, or to legal process.

The agreements are dated May 20, 1924 (the date of the issuance of the policies), and are signed by the decedent, as the insured, and were accepted by the insurance company, by a proper officer thereof, September 8, 1924. Payments of the proceeds of each of the policies have been, and are being, paid in accordance with these agreements since the death of the insured. (R. 133.)

The policy issued by the Metropolitan Life Insurance Company, dated October 20, 1903, named the decedent's mother as beneficiary "if living, otherwise to the legal representatives of the insured." The policy provides that after premiums thereon had been paid for three or more years, the company would grant, as the insured and assured may elect, one of the following options: (a) a loan; (b) the cash surrender value; (c) a paid-up policy. (R. 133–134.)

The other policy issued by the Metropolitan Life Insurance Company, dated October 10, 1892, was of the so-called industrial type. No named beneficiary was designated therein. It provided for a weekly premium payment, and contains a so-called facility of payment clause permitting payment of the proceeds of the policy to either the executor or administrator, husband or wife, or any relative by blood or lawful beneficiary of the insured. It provided that after it had been in force for five years and after the insured had reached the age of eighteen years, the insured might make written application for a paid-up term policy payable to the estate of the insured. (R. 134.)

An estate tax return, in which the four policies hereinbefore described were listed but their proceeds not included in the value of the gross estate, was filed in behalf of the decedent's estate. The Commissioner of Internal Revenue ruled that the

proceeds of the policies should be included in the value of the gross estate; that determination, together with other adjustments not involved in the present proceeding, resulted in a deficiency of $17,315.30. (R. 134–135.)

The judgment of the District Court (R. 145) dismissing the taxpayer's complaint, was affirmed on appeal (R. 158).

ARGUMENT

1. Petitioner states (Pet. 8) that the decision of the Circuit Court of Appeals is in conflict with two decisions of the Circuit Court of Appeals for the Eighth Circuit in *Walker* v. *United States,* 83 F. 2d 103, and *Helvering* v. *Parker,* 84 F. 2d 838, and with the decisions of this Court in *Bingham* v. *United States,* 296 U. S. 211, and *Industrial Trust Co.* v. *United States,* 296 U. S. 220.

All of those cases were decided several years before this Court's decision in *Helvering* v. *Hallock,* 309 U. S. 106, which recognized that the retention of rights contingent upon survivorship furnished the basis for the imposition of estate taxes with respect to property transferred by the decedent during his life time.

Since the *Hallock* decision, like results have been reached in cases of insurance proceeds where the insured had rights contingent upon survivorship. *Chase Nat. Bank* v. *United States,* 116 F. 2d 625 (C. C. A. 2d); *Liebmann* v. *Hassett,* 148

F. 2d 247 (C. C. A. 1st); *Commissioner* v. *Washer*, 127 F. 2d 446 (C. C. A. 6th), certiorari denied, 317 U. S. 653; *Bailey* v. *United States*, 31 F. Supp. 778 (C. Cls.), certiorari dismissed, 311 U. S. 721. The decision below is not in conflict with any authoritative decision of another Circuit Court of Appeals. It is in harmony with the doctrine of the *Hallock* case, as recently applied by this Court in *Goldstone* v. *United States*, decided June 11, 1945, No. 699, October Term, 1944, not yet reported.[1]

2. Whether a certain amendment of the insurance policies was properly treated as a reformation does not present a substantial question requiring the intervention of this Court. Since it ultimately turns upon whether a mistake was made in the insurance application the question depends upon the facts of this particular case and thus is not of general importance.

---

[1] The decisions in the *Bingham* and *Industrial Trust* cases must be read in the light of the subsequent decision in the *Hallock* case. It may be noted that the petition for certiorari in *Commissioner* v. *Washer*, *supra*, similarly relied upon an alleged conflict with the *Bingham* and *Industrial Trust* decisions.

CONCLUSION

The decision below is correct. There is no conflict or any other sufficient basis for a review by this Court. The petition should therefore be denied.

Respectfully submitted.

HAROLD JUDSON,
Acting Solicitor General.
SAMUEL O. CLARK, Jr.,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
LEON F. COOPER,
Special Assistants to the Attorney General.

AUGUST, 1945.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 302 (as amended by Section 404 of the Revenue Act of 1934, c. 277, 48 Stat. 680). The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside the United States.

*   *   *   *   *

(g) To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life.

*   *   *   *   *

Treasury Regulations 80 (1937 ed.):

ART. 25. *Taxable insurance.*—The statute provides for the inclusion in the gross estate of insurance taken out by the decedent upon his own life, as follows: (a) All insurance receivable by, or for the benefit of, the estate; (b) all other insurance to the extent that it exceeds in the aggregate $40,000.

The term "insurance" refers to life insurance of every description, including death benefits paid by fraternal beneficial societies, operating under the lodge system. Insurance is considered to have been taken out by the decedent, whether or not he made the application, if he acquired the ownership of, or any legal incident thereof in, the policy; but in the case of a decedent

dying before November 7, 1934 (the date of approval of the 1934 edition of Regulations 80), the provisions of the second paragraph of article 25 of Regulations 70 (1929 edition) will continue to apply. Legal incidents of ownership in the policy include, for example: The right of the insured or his estate to its economic benefits, the power to change the beneficiary, to surrender or cancel the policy, to assign it, to revoke an assignment, to pledge it for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc.

* * * * *

ART. 27. *Insurance receivable by other beneficiaries.*—The statute requires the inclusion in the gross estate of the decedent of the proceeds of any policy, or the aggregate proceeds of all policies, not receivable by or for the benefit of decedent's estate, to the extent that such proceeds exceed $40,000, regardless of when the policy was or the policies were issued, if the decedent possessed at the time of his death any of the legal incidents of ownership.

The estate is entitled to only one exemption of $40,000 upon insurance receivable by beneficiaries other than the estate. For example, if the decedent left life insurance payable to three such beneficiaries in amounts of $10,000, $40,000 and $50,000 (total, $100,000), the full amount should be listed on the return and therefrom subtracted the $40,000 exemption as provided in the appropriate schedule of Form 706. The word "beneficiaries", as used in reference to the $40,000 exemption, means persons entitled to the actual enjoyment of the insurance money.

U. S. GOVERNMENT PRINTING OFFICE: 1943

No. 244

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

AGNES SCHONGALLA, as Executrix of the Last Will and Testament of William Schongalla, deceased,

Petitioner,

vs.

HARRY M. HICKEY, United States Collector of Internal Revenue, Fourteenth District of New York.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

SUPPLEMENTAL BRIEF ON BEHALF OF PETITIONER.

The respondent's brief of approximately 8 1/2 to 9 pages may leave an impression on this Court that this case does not raise any questions of conflict of law between several of the Federal Circuit Courts of Appeal, or any questions of great public importance.

Such, however, is not the case. The case at bar differs in principle from those referred to by the respondent and presents two important questions of law which we seriously contend are unsettled and of great public importance, and which this Court should finally decide.

One of these questions appears to have been misapprehended by the respondent and the other which involves the question of depriving infants of vested interests without giving them their day in court under a misinter-

pretation of a general rule of the common law is mistakenly and perfunctorily dismissed by the respondent as one which "depends upon the facts of this particular case and thus is not of general importance."

On page 7 of respondent's brief it is stated that the cases relied on by petitioner (*Walker v. U. S.; Helvering v. Parker; Bingham v. U. S.;* and *Industrial Trust Company v. U. S.*) were decided several years before this Court's decision in *Helvering v. Hallock,* 309 U. S. 106, which recognized that the retention of rights contingent upon survivorship furnish the basis for the imposition of estate taxes with respect to property *transferred* by the decedent during his lifetime.

In the case at bar we claim that no property was transferred by the decedent during his lifetime and that the taking out of insurance policies by a decedent in favor of designated beneficiaries does not constitute any transfer of property from the decedent in his lifetime.

This is the very point that we are asking this Court in the case at bar to decide and we claim on reason and principle the doctrine of *Helvering v. Hallock* does not apply. The application of the principle of *Helvering v. Hallock* has caused considerable confusion and unjustifiable doubt to be cast on the *Walker, Bingham* and *Industrial Trust Company* decisions which, in reality, unaffected by *Helvering v. Hallock* should control the decision in the case at bar, and which are still, petitioner contends, sound law.

In our case the decedent never had control over the insurance policies and never made or purported to make any transfer of them. Our case squarely places before this Court the opportunity to clear up the confusion caused by *Helvering v. Hallock* in the lower courts as to whether the mere taking out of a life insurance policy

upon an annual premium basis, with a reservation to the insured, of no rights except the possibility of his estate receiving the policy's proceeds if the beneficiary (owner in law) of the policy should by chance predecease the insured, is rendered taxable by reason of such reservation alone where the contingency referred to does not occur.

Helvering v. Hallock may very well apply to cases like *Bailey v. U. S., Commissioner v. Washer,* and *Chase National Bank v. U. S.* (116 Fed. [2d] 625), cited on pages 7 and 8 of respondent's brief, as in each of those cases the insured controlled the policies in his lifetime and then transferred or assigned his control contingently, however, on his own death. A reading of the decisions in those cases and in *Liebmann v. Hassett,* 148 Fed. (2d) 247, demonstrates in our opinion that the Courts, just as respondent's counsel, have failed to perceive that *Helvering v. Hallock* deals with transfers *inter vivos* as taxable under Section 302 (c) of the Revenue Act of 1926, that while an insurance policy may very well be the subject of a transfer just the same as tangible personal property or intangible choses in action, and accordingly taxable under *Helvering v. Hallock* where the transferor retains an interest to inherit upon the death of the transferee preceding his death, nevertheless the principle or theory of *Helvering v. Hallock* does not apply to a mere direction in an insurance policy to pay the proceeds to the insured's estate if the beneficiary predecease him where there has not been and could not be, since the insured had no control over the policy under its terms, any transfer of the policy. The mere taking out of the policy by the insured from the insurance company, under such circumstances, is dealt with in the *Walker, Parker, Bingham* and *Industrial Trust Company* cases, which are in nowise affected in principle by the decision in the *Hallock* case.

The other questions presented by the petitioner are whether a tax-reviewing Court may pass upon matters of general law involving, of necessity, the rights of third parties—in this case infants at the time when insurance policies were taken out, who are named as the beneficiaries in the policies—without giving them their day in court by requiring, as a matter of due process, a trial of the issues involving such rights. This, it is submitted, is a question of enough public importance to be decided by the Supreme Court of the United States, since here the question arises out of the lower Courts themselves raising the issues and then undertaking, after so raising them, on their own motions, so to speak, to decide them in a proceeding between the United States and the decedent's estate alone, without giving the infants, whose rights are necessarily to be passed upon, their day in court.

In respect to this question, on page 8 of respondent's brief, it is stated:

> "Whether a certain amendment of the insurance policies was properly treated as a reformation does not present a substantial question requiring the intervention of this court."

Will the United States Supreme Court hold that parties may be deprived of vested rights in a tax case to which they are not parties where the Courts decide that an insurance policy may be regarded as reformed and the rights of the beneficiaries adjudicated for tax purposes even though no issue with respect to reformation or to their rights has been with due process of law presented or tried and where they are not before the Court?

Had these infant beneficiaries been represented in any legal proceeding to reform these policies they would have the right that any ordinary human being ought to have, and under our Constitution still has, to produce witnesses and to cross examine them and bring out any evidence

in their favor against a claim that the policies were reformed. Furthermore, the effect and necessary implication of the Circuit Court's decision in this case is that while the beneficiaries of insurance policies may be ultimately liable for the payment of tax thereon under Section 314 (b) of the Revenue Act of 1926, the foundations of their liability may be tried between the government and the estate without proper judicial inquiry being afforded to the beneficiaries.

Such cannot possibly have been the intent of Congress. Is it not incumbent upon a tax-reviewing Court under such circumstances, particularly where the rights of infant beneficiaries are involved, to insist that they have their day in court and the right to a complete examination and cross examination of the evidence rather than to permit the decedent's estate and the government to be the sole contestants and to adjudicate the rights of infants upon evidence not produced on any issue of the infants' rights, but haphazardly applied in the determination thereon?

The question presented by petitioner is not as respondent states—whether a certain amendment of the policies was properly treated as a reformation; that was a conclusory question propounded by the Court itself. The real question submitted by us to this Court is whether the lower Courts, in reviewing the tax liability in the first instance, are not compelled, on being apprised of the existence of collateral issues, upon which the right to tax may depend, to insist upon a trial of those issues and if not tried to refrain from adjudication of them; and, as a corollary, the further question as to whether it is not implied in the Revenue Act that those ultimately liable for taxes on property forming no part of the decedent's legal estate though brought into it for tax purposes, are entitled to judicial inquiry into their rights and liabilities by due process of law, and that where

the adjudication of their rights, as here, becomes manifestly a condition precedent to the determination of their tax liability, the Courts are compelled of their own motion to order and conduct a proper judicial inquiry. The petitioner claims that the insured and the insurance company had no power or authority by agreement between themselves to deprive the infant beneficiaries of vested rights.

For the reasons above given, as well as those contained in our main brief, we pray the Court to grant our application.

Dated: New York, September 20, 1945.

Respectfully submitted,

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Attorney for Petitioner.